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Supreme Court of the United States

OCTOBER TERM, 1926. No. 318

EMPIRE TRUST COMPANY,
Petitioner-Defendant,

against

CHARLES HAZLITT CAHAN,
Respondent-Plaintiff.

BRIEF FOR THE PETITIONER-DEFENDANT

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Supreme Court of the United States

EMPIRE TRUST COMPANY,
Petitioner-Defendant,

AGAINST

CHARLES HAZLITT CAHAN,
Respondent-Plaintiff.

October Term,
1926
No. 318

BRIEF FOR THE PETITIONER-DEFENDANT

This is a writ of *certiorari* in review of the affirmance by the Circuit Court of Appeals for the Second Circuit of a judgment of the United States District Court for the Southern District of New York in favor of the plaintiff in an action at law. The opinion of the Circuit Court of Appeals is printed in the Record, pages 266-285, and is reported in 9 F. (2d) 713. The memorandum filed by the District Judge is printed in the Record, pages 241-244.

The plaintiff sued to recover the proceeds of twenty-one checks, aggregating $31,170, drawn by plaintiff's son, Charles H. Cahan, Jr., under powers of attorney, on funds of the plaintiff on deposit in the Guaranty Trust Company and with the Agents of the Bank of Montreal, both in the City of New York. The checks, which (save in two instances) were certified by the banks on which they were drawn, were deposited by Cahan, Jr., to the credit of his personal account in

the Empire Trust Company, the defendant, in the City of New York, and the proceeds were thereafter drawn by him and used for purposes unknown.

The issue, as stated by the Court below, is:

"Admittedly defendant knew nothing of what its depositor Cahan, Jr., was doing except as information was given by the cheques he offered for deposit; wherefore, the record presents this bald legal question: is an agent's bank of deposit put on notice by, and does it take at its peril if it receives without investigation, a cheque drawn by the agent on his principal's funds to his own order and tendered for the credit of his private account?" (Record, pp. 269-270).

Statement of Facts.

The plaintiff, a Canadian barrister, residing in Montreal, was employed during the war in supervising British munition contracts in this country. The magnitude of the work led him to establish his headquarters in New York City in January, 1915, and in May of that year his son, Charles H. Cahan, Jr., also a Canadian barrister, joined him as an assistant. Father and son lived together, the former paying the living expenses and giving his son $225 a month and an annual bonus of $5,000 or $6,000 (Record, fols. 255, 295).

The plaintiff's duties required much travel. He was frequently in England and traveled throughout the United States. Because of his frequent and long continued absence from New York (fol. 101), he gave his son in 1916 broad powers of attorney on personal accounts carried by him in two New York City banks, the Agents of the Bank of Montreal and the Guaranty Trust Company. By the first, dated May 29, 1916 (at first limited in time and afterwards renewed without limit in duration), he appointed his son his

"attorney, for me, in my name, and on my behalf, to make, sign and draw cheques, on my account with the Agents of the

Bank of Montreal, New York City, and to receive all paid cheques, and to sign the said Bank's form of settlement of balances" (Plaintiff's Ex. 2, fols. 472-476; Ex. 3, fols. 475-479; Ex. 4, fols. 481-485).

By the second, dated September 21, 1916, he appointed his son his

"true and lawful attorney for me and in my name, place and stead, to sign, endorse, deposit, draw, and deliver all such checks and other orders for the payment of money as he may deem proper in connection with any account of funds on deposit which I may now or hereafter have with the Guaranty Trust Company of New York, its agents, successors or assigns; giving and granting unto my said attorney full power and authority to do and perform all and every act and thing whatsoever requisite and necessary to be done in and about the premises, as fully, to all intents and purposes, as I myself might or could do if personally present" (Plaintiff's Ex. 1, fols. 466-470).

The plaintiff's work no longer required residence here after the United States entered the war, and he and his son returned to Montreal in the summer of 1917. Meanwhile, Cahan, Jr., had opened an account of his own in the Empire Trust Company on September 29, 1915. The account is printed in full in the Record, pages 197 to 214. The aggregate deposits to August 4, 1919, when the account was closed, amounted to $70,742.08.

In December, 1919, the disclosure of irregularities in his account in the Bank of Montreal and in the accounts of the Corporation Agency, a Canadian company of which the plaintiff was president and his son a director, the discovery that his son had a personal account in the Home Bank of Canada, and his son's disappearance (fols. 120-125), led the plaintiff to inquire about his deposits in the New York banks, to which he had paid no attention after giving his son authority over them (fols. 283, 284). In January, 1920, the plaintiff

discovered in his son's safe deposit box in Montreal twenty of the cancelled checks on the Guaranty Trust Company and the Agents of the Bank of Montreal upon which this suit was brought, showing collection thereof by the defendant bank, which apprised him for the first time of his son's personal account in the defendant bank (fols. 133-135).

After receiving such assistance from the defendant as the records in its possession afforded (fol. 233), the plaintiff sued on the twenty-one checks described in the complaint. The twenty-first check therein described was not found, but the Guaranty Trust Company's books show that it was drawn on plaintiff's account there, and this is admitted in the defendant's answer; but it is not known how it was drawn. It appears, however, that it was certified (fols. 390-392).

The face, form and contents of the checks are printed in full at pages 163 to 182 of the Record. All the checks are signed "C. H. Cahan, By C. H. Cahan, Jr., His Attorney". Seventeen of the twenty-one checks are payable to the order of Cahan, Jr., three to the order of the Empire Trust Company (Plaintiff's Exhibits 5-C, 5-D and 5-J, fols. 496-498, 499-501, 517-519); the twenty-first check, as stated, has not been found and it is not known how it was drawn. All the checks, save two (Plaintiff's Exhibits 5-R and 5-S, fols. 541-543, 544-546), were either certified by the Guaranty Trust Company or accepted by the Agents of the Bank of Montreal, according as they were drawn on one or the other bank. Thus certified (fols. 381-388, 394-397), all the checks were deposited by Cahan, Jr., to the credit of his account with the defendant bank. Each deposit was accompanied by a deposit slip (fol. 304; Defendant's Exhibits A to A-20, fols. 667-686), save two (Defendant's Exhibits A-1 and A-2, fols. 668-671) received by mail (fols. 378-380, 652-654), for which the deposit slips were made out by the defendant's receiving teller.

The defendant made no loans to Cahan, Jr. (fols. 437-438).

The plaintiff testified that the authority given to his son was intended by him to be exercised only in payment of his own personal expenses (fol. 276). Whether this intention was communicated even to his son does not appear. Nor is it known even now what disposition the son made of the proceeds of the checks in issue (fols. 147-148). The plaintiff testified (fol. 146), as he alleged in his complaint, that the proceeds had not been used for his purposes; "I do not know what he did with it. I have no definite knowledge" (fol. 271). Of course the defendant had none of the cancelled checks, which had been taken up by Cahan, Jr., nor any record of payees (fols. 370-371). It had only the deposit slips which accompanied the checks in issue, which it produced (fols. 303-307).

Pursuant to stipulation the case was tried by a jury of one, on motion by each party for a directed verdict (fols. 86, 458-459). At the trial the defendant withdrew the second, third, fourth and fifth separate defenses alleged in the answer (pars. Twelfth to Twenty-first, inclusive, fols. 57-71; fols. 183, 185, 84-85). The District Judge finally directed a verdict in favor of the plaintiff for $31,170, the aggregate amount of the checks in issue, without interest (fol. 454), and filed a written memorandum in explanation of his action (fols. 722-732).

On writ of error to the Circuit Court of Appeals, the defendant assigned error upon the direction of the verdict and the plaintiff upon the disallowance of interest (fols. 740-770). The Court below affirmed the judgment of the District Court with respect to the principal amount, the face value of the twenty-one checks in issue; and, reversing the judgment below to this extent, allowed interest thereon from the dates when

they were respectively credited by the defendant to Cahan, Jr. (Record, pp. 266-285). It held expressly that Cahan, Jr., had both actual and apparent authority to draw the checks, but that his misappropriation lay in what he did with them (p. 270). Conceding that the "defendant knew nothing of what its depositor, Cahan, Jr., was doing, except as information was given by the cheques offered for deposit" (p. 269), the Court nevertheless followed "the judge-made business safeguard against dishonesty asserted by this court in *Havana, etc.* v. *Central, etc.*, 204 Fed. 546, at page 548" (p. 272), although admitting that the cases "nowhere state the rule in the compendious and far-reaching form in which it was put by Judge Noyes", in that case (p. 278).

ARGUMENT

I. The defendant did not participate in the diversion of the plaintiff's funds with knowledge or notice of fraud.

One who deals with commercial paper drawn by a fiduciary (whether a mere agent or formal trustee) may become liable for the fiduciary's misappropriation of funds.

First, by a violation of the contract of deposit between the owner of the funds and his depositary bank; in other words, by payment without authority;

Second, by participating in a diversion of the funds with knowledge or notice of the fraud; for example, by appropriating the funds in payment of the fiduciary's indebtedness (*National Bank* v. *Insurance Co.*, 104 U. S. 54; *Union Stock Yards Bank* v. *Gillespie*, 137 U. S. 411; *Ward* v. *City Trust Co.*, 192 N. Y. 61).

The two grounds of liability are distinct, and the failure to observe the distinction explains the confusion in many of the decided cases.

1. Cahan, Jr., had authority to draw the checks in issue.

The Court below clarified the issue by holding, contrary to the view of the District Judge (fol. 725), that Cahan, Jr., "had both actual and apparent authority to draw the twenty-one cheques, and the misappropriation of which he was undoubtedly guilty lay not in the drawing of the cheques but in what he did with them" (p. 270).

An erroneous conception of authority pervades the plaintiff's case. The complaint alleges that Cahan, Jr., "had no power or authority under any of the said recited powers of attorney, to make, sign or draw checks of the plaintiff for the purpose of transferring or appropriating to himself or for his own personal and private use or benefit the funds of the plaintiff". And the plaintiff contends that this is so, because the law reads into every authorization to an agent to act for a principal the limitation that it is to be used for the benefit of the principal, not for the purposes of the agent. We admit that this implication is valid without qualification as applied to the relation between the agent and his principal. But when the rights of a third person intervene, the statement requires modification. The fact that an agent acts for his own benefit without actual authority is immaterial as against a third person who deals with the agent on the face of his apparent authority. To say that the agent must act for the benefit of his principal refers to the use to be made of the funds, not to the power; it relates to the purposes of the execution, not to the scope of the power.

The point is fully discussed on principle and authority in *North River Bank* v. *Aymar*, 3 Hill (N. Y.) 262; *Hambro* v.

Burnand, [1904] 2 K. B. 10, and *Lloyd* v. *Grace, Smith & Co.*, [1912] A. C. 716; and it was applied by this Court in *National Safe Deposit Co.* v. *Hibbs*, 229 U. S. 391, and by the Circuit Court of Appeals for the Sixth Circuit in *Warren-Scharf Asphalt Paving Company* v. *Commercial National Bank*, 97 Fed. 181.

The defendant may rely upon the powers of attorney in evidence, although it had not examined them. *Ward* v. *City Trust Co.* 192 N. Y. 61, 70; *Hambro* v. *Burnand*, [1904] 2 K. B. 10, 24, 26; *London Joint Stock Bank* v. *Simmons*, [1892] A. C. 201, 220.

2. The form and deposit of the checks did not charge the defendant with notice of misappropriation.

A fiduciary having general authority to draw funds must necessarily have power to direct their disposition. The plaintiff entrusted authority over his funds to his son. The deposit with the defendant bank did not operate to take the funds out of his son's control. So long as the funds remained in Cahan, Jr.'s control they were not diverted. Accordingly, it is almost universally held that a fiduciary, of whatsoever kind, may deposit the funds of his principal in a bank to his individual credit.

Whiting v. *Hudson Trust Co.*, 234 N. Y. 394; *Fidelity & Deposit Co.* v. *Queens County Trust Co.*, 226 N. Y. 225; *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106;

Kendall v. *Fidelity Trust Co.*, 230 Mass. 238; *Allen* v. *Puritan Trust Co.*, 211 Mass. 409, 423; *City of Newburyport* v. *Spear*, 204 Mass. 146, 150; *Batchelder* v. *Central National Bank*, 188 Mass. 25;

Santa Marina Co. v. *Canadian Bank*, 254 Fed. 391 (certiorari denied 250 U. S. 643); *Commercial*

Sac. Bank & T. Co. v. *Nat. Surety Co.*, 294 Fed. 261;

Goodwin v. *American National Bank*, 48 Conn. 550;

Brookhouse v. *Union Publishing Co.*, 73 N. H. 368;

Hood v. *Kensington National Bank*, 230 Penn. St. 508;

Duckett v. *Mechanics Bank*, 86 Md. 400;

United States Fidelity & Guaranty Co. v. *Home Bank*, 77 W. Va. 665;

McCullam v. *Third National Bank*, 209 Mo. App. 266; *Gate City Building & Loan Association* v. *National Bank*, 126 Mo. 82;

Mott Iron Works v. *Metropolitan Bank*, 78 Wash. 294; *Rice* v. *Peoples Savings Bank*, 247 Pac. (Wash.) 1009;

Southern Trust & Commerce Bank v. *San Diego Savings Bank*, 60 Calif. App. 215; *United States Fidelity & Guaranty Co.* v. *First National Bank*, 18 Calif. App. 437;

State v. *Farmers & Merchants Bank*, 112 Neb. 840;

Interstate National Bank v. *Claxton*, 97 Tex. 569;

The Corporation Agencies, Ltd. v. *The Home Bank of Canada* (Privy Council, Jan. 18, 1927), Appendix, p. 29; *Gray* v. *Johnston*, L. R. 3 Eng. & Ir. App. 1; *Coleman* v. *Bucks & Oxon Union Bank*, [1897] 2 Ch. 243; *Shields* v. *Bank of Ireland*, [1901] 1 Ir. Rep. 222.

If he possess the right to do so, it necessarily follows that the bank has the right to accept the deposit. Knowledge on the part of the bank of the nature of the funds received does not affect the character of the act. The bank has the right to assume that a fiduciary will apply the funds to their proper use under the trust. *Bischoff* v. *Yorkville Bank*, 218

N. Y. 106; *Town of Eastchester* v. *Mt. Vernon Trust Co.*, 173 App. Div. 482; *City of Newburyport* v. *First National Bank*, 216 Mass. 304; *Safe Deposit & Trust Co.* v. *Bank*, 194 Penn. St. 334; *Munnerlyn* v. *Bank*, 88 Ga. 333; *Martin* v. *Bank*, 66 Kan. 655; *State* v. *Farmers & Merchants Bank*, 112 Neb. 840; *Charleston Paint Co.* v. *Exchange Banking Co.*, 129 S. C. 290; and cases cited *supra*.

This is now the settled law of New York. The Court of Appeals said in *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, 111:

"A fiduciary may legally deposit the trust funds in a bank to his individual account and credit. Knowledge on the part of the bank of the nature of the funds received and credited does not affect the character of the act. The bank has the right to presume that the fiduciary will apply the funds to their proper uses under the trust. There are judicial decisions, in cases in which the fiduciary has converted the funds, which hold the contrary (*U. S. Fidelity & G. Co.* v. *Peoples Bank*, 127 Tenn. 720; *Bank of Hickory* v. *McPherson*, 102 Miss. 852). The rule stated by us is, however, established in this and other jurisdictions, as the decisions hereinafter cited will disclose, and accords with reason."

In the recent case of *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, 402, Judge Cardozo said:

"What it did was to accept the check for the use of the depositor upon an agreement that the proceeds should be subject to his order. When the order was given and the money disbursed, the situation was the same as if cash had been delivered for safekeeping and afterwards returned. In such a situation, the defendant is to be held liable, if at all, only upon a showing that by the form of the account it has facilitated a conversion and made itself, in so doing, a party to a tort (*Allen* v. *Puritan Trust Co.*, 211 Mass. 409, 422; *Squire* v. *Ordemann*, 194 N. Y. 394). But nothing that was done by the defendant did facilitate a conversion. Eckerson was the payee of the check with power to collect it. His power was neither increased nor diminished by the form of the deposit. He was the owner of a chose in action whether subject to a

trust or free from one. Under the law as it then stood,* a trustee did not convert the moneys of the trust by the mere act of depositing them in a bank in his individual name (*Bischoff* v. *Yorkville Bank, supra; Sagoney* v. *Mackey*, 225 N. Y. 594, 599; *Wickenheiser* v. *Colonial Bank*, 168 App. Div. 329, 333; 224 N. Y. 650)."

Such is the rule in Massachusetts, *Kendall* v. *Fidelity Trust Co.*, 230 Mass. 238, 241, where the Court said:

"As the defendant had no interest in the deposits and never received any part thereof for the payment of any debt due it, but credited all amounts so collected to Alvero's personal account, it cannot be charged with constructive notice of the fraudulent conduct of the fiduciary. * * * The weight of authority is in accord with the view that if a bank, acting in good faith, merely credits trust funds, knowing them to be such to the personal account of the fiduciary, it will not be liable if he later misappropriates such funds. Cases cited in note to *Allen* v. *Puritan Trust Co.*, L. R. A. 1915 C 518. As the defendant cannot be charged with constructive notice of the fraudulent acts of Alvero merely because of the form of the checks and because the amounts collected thereon were deposited in his personal account with other funds deposited by him, it follows that there is no evidence that the defendant knew he intended to misappropriate the funds and the defendant therefore cannot be held liable."

See, also, *Goodwin* v. *American National Bank*, 48 Conn. 550, and *Mott Iron Works* v. *Metropolitan Bank*, 78 Wash. 294.

While there could be little doubt about English law on this issue after *Gray* v. *Johnston*, L. R. 3 Eng. & Ir. App. 1, English law is now conclusively settled by the decision of the

* This refers to the provisions of Chapter 588 of the Laws of 1916 (now Sections 104 and 231 of the Surrogates' Court Act), whereby an executor, administrator, guardian or other testamentary trustee is required to invest or deposit funds as such, on pain of removal and of misdemeanor. This statute does not change the rule of law relating to the liability of a bank receiving checks for deposit by the testamentary trustee in his own name (*Manufacturers' Trust Co.* v. *United States Mortgage & Trust Co.*, 122 Misc. 726, 730-732; affirmed 213 App. Div. 345).

Judicial Committee of the Privy Council in the case of *The Corporation Agencies, Ltd.* v. *The Home Bank of Canada*, on January 18 last. Since it has not yet been reported, we have printed it as Appendix hereto, page 29. This is not only the latest authoritative expression of the law; it is applied to the precise issue and arises out of the activities of Cahan, Jr., himself. Reference has been made in the statement, page 3, *supra*, to the plaintiff's testimony that he first discovered his son's irregularities in connection with the accounts of the Corporation Agencies, a Canadian company of which the plaintiff was president and his son a director; and that the plaintiff then learned that his son had an account of his own in the Home Bank of Canada. It appears that Cahan, Jr., had made use of the Corporation Agencies' account to further his fraudulent operations. Between March 29 and December 20, 1919, Cahan, Jr., as director and the secretary-treasurer (a party to the fraud), who were authorized by the by-laws to draw checks, drew a number of checks, some payable to the order of Cahan, Jr., others payable to the order of the Home Bank. The checks were then paid into Cahan, Jr.'s personal account with the Home Bank. In other words, the situation in its legal aspects was like the case at bar. The Privy Council held that the defendant was not put on notice:

"For by way of illustration, take again the first cheque, that for $500, of the 29th March 1919. When Cahan, Junior, paid that cheque into his account at the defendants' bank, suppose the bank had asked, 'For what is this cheque given for?' would he have been bound to answer? The cheque might have been for salary or for a sum due to Cahan, Junior, on any other account. The defendant bank had no duty to enquire as to the obligation in respect of which it was given. They would in ordinary course of business taken the cheque and if on presentation to the Merchants' Bank payment were refused, they would debit their customer with the amount.

During April three like cheques for $300, $498.74 and $298.15, were endorsed and handed to the defendant bank by

Cahan, Junior. The practice of the Merchants' Bank was not to issue a pass-book, but to render monthly accounts. Such monthly accounts were duly rendered for March and April, 1919, to the Company. These contained the cheques above referred to. Thus the plaintiffs knew (so far as the defendant bank had knowledge or reason to believe) that the March and April cheques, drawn as they were in favour of Cahan, Junior, were being accepted by the Company as being on their face in order. And so matters went on during the subsequent months, and *a fortiori* the defendant bank had every reason to believe, as successive monthly accounts were sent and no objection raised, that the cheques were legitimate and not in fraud of the Company. The Company were, unfortunately for them, in the hands of fraudulent agents, but the defendant bank had neither knowledge nor notice that that was so and, in fact, from the unquestioned acceptance of the monthly accounts, were entitled to believe the contrary."

If the plaintiff could deposit the funds in his own account, he could draw them out. If the former constituted no notice of diversion, neither would the latter. The law does not require the bank to assume the hazard of correctly reading in each check the purpose of the drawer. *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, 112, where the court said:

"The presumption is, and after the deposits are made remains until annulled by adequate notice or knowledge, that the depositor would preserve or lawfully apply the trust funds. The contract, arising by implication of law, from a general deposit of moneys in a bank is that the bank will, whenever required, pay the moneys in such sums and to such persons as the depositor shall direct and designate. Although the depositor is drawing checks which the bank may surmise or suspect are for his personal benefit, it is bound to presume, in the absence of adequate notice to the contrary, that they are properly and lawfully drawn."

See also, *Kendall* v. *Fidelity Trust Co.*, 230 Mass. 238; *City of Newburyport* v. *First National Bank of Boston*, 216 Mass. 304; *Goodwin* v. *American National Bank*, 48 Conn. 530.

The plaintiff seeks to distinguish the case of *Bischoff* v.

Yorkville Bank, 218 N. Y. 106, *supra*, on the ground that the acts of an executor were there involved, and that the court pointed out that an executor has title to the assets in his hands. We quote the court's statement of the legal principle applicable to fiduciaries, which the cases cited by the court show does not depend upon any consideration of legal title. In the case of *Fidelity & Deposit Co.* v. *Queens Trust Co.*, 226 N. Y. 225, *supra*, the trustee in bankruptcy whose checks were in issue also had legal title to the funds, but no reference is made to that fact; and the cases cited do not proceed upon that ground.

The rule has been applied in numerous cases in which the fiduciary had no legal title: agents, attorneys, corporate officers, public officers, etc. *The Corporation Agencies, Ltd.*, v. *The Home Bank of Canada*, Appendix, p. ; *Kendall* v. *Fidelity Trust Co.*, 230 Mass. 238; *Safe Deposit & Trust Co.* v. *Bank*, 194 Pa. St. 334; *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394; *Mott Iron Works* v. *Metropolitan Bank*, 78 Wash. 294; *Charleston Paint Co.* v. *Exchange Banking & Trust Co.*, 129 S. C. 290; *Santa Marina Co.* v. *Canadian Bank*, 254 Fed. 391; *Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422; *Gate City Building & Loan Assn.* v. *National Bank of Commerce*, 126 Mo. 82; *McCullam* v. *Third National Bank*, 209 Mo. App. 266; *Goodwin* v. *American National Bank*, 48 Conn. 550.

On principle there can be no valid distinction since possession of a check payable to the order of the holder is presumptive evidence of ownership. *Havana Central R. R. Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422, 428. This is made clear by our quotation, *supra*, from *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, 402, 403. There the first check with which the Court deals was drawn by an attorney in fact. As Judge Cardozo says, "He was the owner of a chose in action whether subject to a trust or free from one."

This subject is covered fully in an article by Professor Scott in 34 Harvard Law Review, 454 (1921). He treats trustees and agents as being in the same category. At pages 469-470 he cites numerous decisions and states the law as follows:

"Thus if a trustee or other fiduciary indorses a check payable to him as trustee and deposits the same to the credit of his individual account, the bank is under no duty to make inquiry as to the propriety of the depositor's conduct. So too if a trustee draws a check upon an account in another bank standing in his name as trustee, and deposits the same to his individual credit with the defendant bank, the latter bank is not bound to inquire as to the propriety of the trustee's conduct."

There is no liability for participation in the wrongdoing of a fiduciary unless the person dealing with him is chargeable with notice of his misconduct. Since this is the test of liability, it is immaterial whether the fiduciary is a trustee with legal title or an agent with a power of disposition.

In the course of the vast daily volume of business conducted with bank checks drawn in a representative capacity, there is legitimate need in a multitude of instances that the representative should order payment of these instruments to himself or to third persons, both for the purposes of the principal and for his personal uses. If he is an authorized officer of a corporation he uses the corporation check to pay himself his salary, or dividends if he is a stockholder, or expenses of a business trip, or to obtain cash to purchase supplies or for payroll purposes.

For aught the bank would know, though a check is payable to its depositor in a representative capacity, the money would belong absolutely to him. *U. S. Fidelity & Guaranty Co. v. Home Bank for Savings*, 77 W. Va. 665. In the case at bar, having regard to the plaintiff's pur-

poses, in view of his long continued absences, in employing his son, the checks might have been for the son's salary or his annual bonus, or family living expenses; or it might represent money already paid out by him in discharge of his fiduciary duties. *The Corporation Agencies, Ltd.* v. *The Home Bank of Canada*, Appendix, pages 29, 35; *U. S. Fidelity & Guaranty Co.* v. *Home Bank for Savings*, 77 W. Va. 665.

Banks are called upon to receive these fiduciary checks without inquiry concerning the purposes for which the checks are used, in reliance upon the presumption that the representative is acting honestly. In view of the vast number of items handled daily, inquiry of the principal is absolutely impracticable. Such inquiry, if made, with the attendant delay, would be certain to be resented as an unwarranted and unnecessary interference with the principal's business and an imputation upon the fiduciary's honesty. Thus banks are called upon to handle this volume of representative checks as so much currency, signed by a fiduciary who has power to control and dispose of the funds, without time or opportunity for investigation of the integrity of his purposes.

The practical aim of the Court below is to establish a "judge-made business safeguard against dishonesty" because, it is said:

"In the case of agents acting by procuration, if there be no such rule, if, for instance an attorney in fact can as such attorney not only withdraw his principal's funds from one bank, as he plainly has a right to do, but deposit them in another (or even perhaps in the same bank) to his own credit without any responsibility on the part of the bank accepting such deposit, a principal who gives a power of attorney, a private corporation which gives unusual powers to its financial officer, a municipality which can only act through its elected or appointed officers, is left without any remedy except that which the Connecticut court thinks is all that the law gives, *i. e.*, the integrity of its fiduciary" (p. 281).

But in all such cases the principal who confers the authority may limit it as he sees fit, or the agent may be bonded. If the principal sees fit to trust the agent with unlimited authority, its abuse affords no reason for visiting the consequences upon others. Fidelity is the sole guaranty of faith. No safeguard is effective. For a dishonest fiduciary, so long as he acts under general powers, can always draw cash and misappropriate it.

The generally accepted rule is neither arbitrary nor fanciful. It is both just and equitable. The owner of the funds trusts his agent. He tells the bank to pay out his funds on his agent's order. In this case the agent has proved false to his trust, and some innocent person must suffer. This Court has said that under such circumstances "the principles which underlie equitable estoppel place the loss upon him whose misplaced confidence has made the wrong possible". *National Safe Deposit Co.* vs. *Hibbs*, 229 U. S. 391, 397.

(a) *Certification.*

Moreover, all but the last two checks were certified or accepted by the plaintiff's depository banks. The effect of this, according to the New York rule, is stated by the Court of Appeals in *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, 404:

"The payee of the check, before delivering it to the defendant, had caused it to be certified. The legal result was the same as if he had received the cash over the counter (*Freund* v. *Imp. & T. Nat. Bank*, 76 N. Y. 352; *Carnegie Trust Co.* v. *First N. Bank of N. Y.*, 213 N. Y. 301; *Meuer* v. *Phenix Nat. Bank*, 94 App. Div. 331; 183 N. Y. 511). Between the drawee bank and its depositor, the check had been paid (Neg. Inst. Law, § 324; Consol. Laws, ch. 38; *Gallo* v. *Brooklyn Savings Bank*, 199 N. Y. 222). The payee was the owner of a chose in action, the drawee's promise to pay, just as much as if he were the holder of a cashier's draft (*Goshen Nat. Bank* v. *State of N. Y.*, 141 N. Y. 379; *Jusith* v.

Nat. Bank of the Commonwealth, 56 N. Y. 478, 480). What the defendant turned into money was not the obligation of the maker, but that of the drawee. In such circumstances, the act of collection for the account of the depositor was neither a conversion nor anything that had a proximate relation in aiding a conversion. The drawee would have paid in discharge of its own promise if Eckerson rather than the defendant had come to it with the check and demanded payment of the money. If this had been done, and the money then handed to the defendant, there would hardly be a claim that a tort would have resulted, though the money was received with knowledge of its origin. The intervention of a cashier's draft or its equivalent changes the transaction in form, but not in substance (*Goshen Nat. Bank* v. *State of N. Y.*, *supra*)."

In other words, as this Court said in *Merchants Bank* v. *State Bank*, 10 Wall. 604, 648:

"The object of certifying a check, as regards both parties, is to enable the holder to use it as money. The transferee takes it with the same readiness and sense of security that he would take the notes of the bank. It is available also to him for all the purposes of money."

The Court below took direct issue with this view of certification. Although the legal result of certification be the same as if Cahan, Jr., had received the cash over the counter, Judge Hough asserts that this action "would have lain just as well if Cahan, Jr., had actually drawn the cash and deposited the same with defendant but had then contemporaneously informed defendant that he had drawn the money from his father's account by virtue of his letter of attorney and now wished it to go to his personal credit" (p. 275). No authority was cited for such a harsh rule, which would seriously impair the legitimate transfer of funds and impose upon banks the burden of insuring the integrity of fiduciaries. Judge Hough's statement that "certification is not a guaranty of the identity or authority of the payee" (p. 283) would

seem to be immaterial in view of his finding that Cahan, Jr., "had both actual and apparent authority to draw the twenty-one cheques" (p. 270).

(b) *Cases relied upon by the Court below.*

Brief reference may be made to the cases relied upon by the Court below. The Court expressly followed an *obiter dictum* by Judge Noyes in *Havana Central Railroad Co.* v. *Central Trust Co.*, 204 Fed. 546, 551. That was a suit against the drawee, or principal's, bank. Having decided that the bank was not put upon inquiry by checks drawn to the agent's order, the issue was disposed of. Yet Judge Noyes went on to say:

"But if the bank have knowledge that the officer is using the check for his personal benefit, *e. g.*, to pay his debt to the bank or to deposit it to his personal credit, then the bank is put upon inquiry, and if it fail to make it, pays at its peril."

Judge Noyes was still thinking of the Court of Appeals' disposition of the suit against the agent's, or payee, bank in *Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422, to which most of his opinion was directed.

The Court below also devoted much attention to the error of the Court of Appeals in the *Havana Railroad* case. This was quite unnecessary because the Court of Appeals had admitted in *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, 423, that the relation between the bank and its depositor was that of debtor and creditor, not of agency. The defendant relies upon *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, and the *Whiting* case, *supra*, for the New York rule. The *Whiting* case is the latest and most comprehensive review of the subject. Besides correcting the error in the *Havana Railroad* case in 198 N. Y., it limits *Wagner Trading Co.* v. *Battery*

Park National Bank, 228 N. Y. 37, to cases of endorsement, and settles the law in accordance with the *Bischoff* case. And it did not go off, as the Court below thought, on the fact that the check was certified. After deciding that the Trust Company was not put on notice by the first check, drawn by Eckerson, attorney, to the order of Eckerson, trustee (234 N. Y. 402, 403), the Court then addressed itself to the plaintiff's additional point that the deposit was wrongful because of the description of the maker. "One answer to this point suffices, though others may be available. The payee of the check, before delivering it to the defendant, had caused it to be certified" (pp. 403, 404).

The Court below quotes from the opinion in *Anderson* v. *Kissam*, 35 Fed. 699. But that was a case where there was actual notice of fraud. The cashier of a bank, who was a customer of the defendants, a firm of stockbrokers, delivered to the defendants from time to time checks of his bank upon another bank, its correspondent, drawn by him in his official capacity. The defendants collected them from the bank on which they were drawn and applied the proceeds on the cashier's account with them for stock speculations on margin. The defendants therefore knew that the cashier was using the proceeds of the checks in his personal transactions, and were accordingly liable for the proceeds.

The majority opinion of the Circuit Court of Appeals for the Ninth Circuit in *Farmers' Loan & Trust Co.* v. *Fidelity Trust Co.*, 86 Fed. 541, is based expressly upon the fact that the agent asked for and received from the bank a certificate of deposit in his individual name, which was held to be equivalent to a declaration by him that the money was received by him for his individual use. The dissenting opinion denied that the circumstance that a certificate of deposit was obtained was of itself calulated to put the bank

upon inquiry as to the use to which the money was to be put.

The Court below relies upon a statement of law made by the Circuit Court of Appeals for the Eighth Circuit in *Oklahoma State Bank* v. *Galion Iron Works & Mfg. Co.*, 4 Fed. (2d) 337. This statement is not sustained by any of the cases cited in its support; all of them are either cases of clear lack of authority or of actual notice of fraud. The case was decided on lack of authority. A manufacturing company which sold its machinery to township boards and county commissioners through sales agents, received payment, after appraisal, by means of warrants on township and county treasurers. Sales agents receiving these warrants were required to transmit them to the home office of the company, which collected them when funds were available in the respective treasuries to pay them. A sales agent endorsed a number of these warrants in the name of the company, discounted them with the defendant bank, placed the proceeds to his individual credit, and afterward drew out and appropriated the proceeds.

The English case of *A. L. Underwood, Ltd.* v. *Bank of Liverpool* [1924], 1 K. B. 775, is a further example of absence of authority. The plaintiff sued the bank for converting certain checks. The connection of the defendant bank with these checks was that A. L. Underwood, who was the sole director of the plaintiff company, paid them into his private account at the defendants' bank for collection, having as sole director of the company endorsed them "A. L. Underwood, Ltd.: A. L. Underwood, Sole Director." The defendant bank collected them, paid the proceeds into A. L. Underwood's individual account and honored checks drawn by him against them. The bank was held liable on the ground that Underwood did not purport to act in the transaction under

any authority from the company. The checks were plainly, on their face, the property of the company, and were endorsed by Underwood as sole director. He did not purport, in dealing with the checks as he did, to be acting as agent for the company; he was acting and purporting to act for himself as principal.

(c) *Indebtedness and notice according to the District Court.*

The defendant made no loans to Cahan, Jr. (fols. 437, 438). The Court below found that the transfer by the twenty-one checks of the funds and the expenditure thereof were "certainly not to pay any indebtedness of Cahan, Jr., to defendant, as Empire Trust never loaned any money to that depositor" (p. 267). This finding disposes of the District Judge's intimation that three of the checks "would seem" to have been in payment of such indebtedness (fol. 727), as well as the plaintiff's suggestion of "threatened overdraft", for an overdraft is a form of indebtedness (*Bacon v. United States*, 97 Fed. 35, 43). Neither theory was well founded, as a brief reference to the facts will show.

The proof shows that the three checks drawn to the order of the defendant (Plaintiff's Exs. 5-C, 5-D, 5-J, fols. 496, 499, 517) were deposited, like the checks payable to his order, to Cahan, Jr.'s credit. The deposit slips which accompanied the checks (Defendant's Exs. A-10, A-16, A-17, fols. 680, 689, 691) directed deposit to his account. These checks had also been certified. In view of the uncontroverted fact, it is difficult to understand how the District Judge could suppose that the defendant was charged with notice that Cahan, Jr. was actually using these three checks for his personal benefit (fol. 726), unless he thought they had been drawn to pay indebtedness. Cahan, Jr. had authority to draw these checks,

and when by his direction they were deposited to his credit, the same presumption attached to them as to the other checks, and the defendant was no more chargeable with notice in one case than it was in the other. Several checks involved in *The Corporation Agencies, Ltd. v. The Home Bank of Canada*, Appendix, p. 32, were drawn to the bank's order. Certainly the case of *Newton v. Guerin*, 279 Fed. 256, which the District Judge cited as authority, lends no support to his conclusion. For that case simply held that an importer who had deposited with a collector of customs a check payable to the latter's order, for the specific purpose of securing the release of goods pending the receipt of a proper bill of lading, could recover the amount from the collector who had applied the proceeds to the payment of duties of third persons. Nor is the case of *Sims v. U. S. Trust Co.*, 103 N. Y. 472, which the plaintiff cites, in point. For in that case the plaintiff entrusted to another his check payable to the order of the defendant bank, with instructions to deposit it to his credit. The person in possession of the check delivered it to the defendant, but obtained from the bank a certificate of deposit payable to himself as trustee for the plaintiff, and thereafter drew the money and appropriated it to his own use. The bank dealt with him in an isolated transaction in reliance upon his mere possession of the check. The certificate of deposit conveyed express notice of the ownership of the funds, and the court held that the bank was liable for paying out the funds without authority.

In the absence of proof of overdraft, the plaintiff suggests "threatened overdrafts" on certain days when Cahan, Jr.'s account would have been overdrawn if he had not deposited the checks dated August 1, 1916, September 1, 1916, April 12, 1917, and May 26, 1917 (Plaintiff's Exs. 5-A, 5-B, 5-M, 5-N, pp. 164, 165, 176, 177). All these checks were certified the

day they were drawn, as noted on the deposit slips (Defendant's Exs. A-6, A-7, A-18, A-19, pp. 226, 231, 232). Overdrafts were invariably entered in red ink (fols. 417, 418, 420, 421), and the only such entry in the defendant's ledger (Plaintiff's Ex. 11, pp. 197-214) was on December 9, 1915, for which date the debit appears on a line above the deposit. Three of the deposits in question are on a line above the day's debit, which signifies receipt and posting of the deposits before receipt and posting of the checks (fols. 311, 332, 358), while the deposit and the debit of September 1, 1916, both appear on the same line at the foot of the ledger, where the bookkeeper posted them instead of using a new ledger sheet (fol. 346). The deposit of September 1, 1916, evidently preceded the debit; otherwise a red ink entry would have been made (fol. 416).

It does not follow that Cahan, Jr.'s account would have been overdrawn but for the deposits; for if his checks had been received by the bank before his deposits, the bank might not have charged his checks until deposits were received to cover them.

Approval of the check of August 1, 1916, for "immediate credit" plainly shows that it was not received for collection. The absence of special approval of the other three checks was of no importance, because they were immediately credited to the depositor on the day they were drawn, certified and deposited. All were payable to Cahan, Jr., and endorsed and deposited by him without restriction and credited immediately. The defendant therefore became his debtor and not an agent for collection. *Douglas* v. *Federal Reserve Bank*, 271 U. S. 489, 492; *Burton* v. *United States*, 196 U. S. 283, 302, 303; *Cragie* v. *Hadley*, 99 N. Y. 131.

The deposit slips (Defendant's Exs. A-6, A-7, A-18, A-19, pp. 226, 231, 232) read in the light of the defendant's regular

practice show a certification of these four checks prior to their deposit by Cahan, Jr. (fols. 382, 383, 384, 397). He himself made out three of the slips, A-6, A-18 and A-19 (fol. 444). He was the payee of all four and doubtless procured their certification, which discharged the drawer and any endorser from liability thereon (Sections 2 and 324, New York Negotiable Instruments Law). It was not the bank's custom to send out for certification checks deposited by its customers (fol. 397). None of these checks was dishonored by the drawee bank. All show payment through the New York Clearing House on the date of their receipt by the defendant. Neither the rule for allowance of twenty-four hours for clearance, nor the bank's right to charge them back if dishonored, made the defendant an agent for collection (*Heinrich* v. *First National Bank*, 219 N. Y. 1; *Douglas* v. *Federal Reserve Bank*, 271 U. S. 489, 493).

3. The defendant was a holder in due course under negotiable instruments law.

So far we have treated the issue from the standpoint of the law of agency and equity. The same result is reached under the law of negotiable instruments. Section 91 of the New York Negotiable Instruments Law (Laws 1909, Chap. 43) defines a holder in due course to be

"a holder who has taken the instrument under the following conditions: (1) That it is complete and regular upon its face; (2) That he became the holder of it before it was overdue, and without notice that it had been previously dishonored, if such was the fact; (3) That he took it in good faith and for value; (4) That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it."

The checks were plainly complete and regular upon their face. They were all payable on demand, and none was dis-

honored. Indeed, all but two had been certified. Title vested in the defendant immediately upon their deposit. *Douglas* v. *Federal Reserve Bank*, 217 U. S. 489, 492. We have already shown that the defendant took them in good faith and for value. Subdivision 4 of Section 91 must be read in connection with Section 95, which provides:

"To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

The defendant had no actual knowledge of any infirmity or defect in the checks. Neither their form nor the circumstances of their negotiation by Cahan, Jr. made the defendant guilty of bad faith in receiving them for his account.

There is no distinction between the checks naming the defendant as payee and those naming Cahan, Jr. A payee as well as an endorsee may be a holder in due course. *Armstrong* v. *American Exchange Bank*, 133 U. S. 433, 453; *Boston Steel & Iron Co.* v. *Steuer*, 183 Mass. 140, 143; *Colonial Fur Ranching Co.* v. *First National Bank*, 227 Mass. 12, 14; *Bergstrom* v. *Ritz Carlton*, 171 App. Div. 776, 781, appeal dismissed 220 N. Y. 569; *Drumm Construction Co.* v. *Forbes*, 305 Ill. 303, 307; *Johnston* v. *Knipe*, 260 Pa. 504; and *Brannan's The Negotiable Instruments Law*, 3 ed., pp. 52 53.

II. The Court below applied an erroneous criterion of notice.

Regarding the matter as one of business convenience, the Court below said:

"It is never doubted that if a bank of deposit has notice which would lead that fiction of the law a 'reasonable man' to suspect wrong, the bank which fails either to verify or dispel that suspicion is answerable for the results" (p. 278).

"There are indeed cases in which it might be in the principal's interest for the agent to withdraw funds from the principal's account and deposit them in his own account, even in a bank of the same city or in the same bank. The only case we can think of is one in which the agent wanted to conceal his principal's name in a transportation in which even a cashier's check might excite suspicion. But the payment of the agent's own debt might in fact be a part of such a transaction, and that possibly does not seem to us sufficient justification. We must balance probabilities and conclude that we hold the form of the check should be taken as evidence that the agent is engaged upon ventures of his own, and as to his authority to conduct the same the bank must assume the risk of investigation" (p. 281).

This is not the criterion of notice which Judge Hough asserted in writing for the Court below in *Gerseta Corporation* v. *Wessex Campbell Silk Co.*, 3 Fed. (2d) 236, 238:

"We conclude that the statute means and says that under section 91, a holder must take in good faith, but if he does not take in bad faith, his good faith is sufficiently shown, and bad faith under section 95 means that he must have knowledge of facts which render it dishonest to take the particular piece of negotiable paper under discussion. Knowledge, not surmise, suspicion, or fear, is necessary; not knowledge of the exact truth, but knowledge of some truth that would prevent action by those commercially honest men for whom law is made."

Nor does it accord with his quotation in that case from *Cheever* v. *Pittsburgh, etc., Co.*, 150 N. Y. 59, 65, as follows:

"Further the transferee holder 'is not bound at his peril to be on the alert for circumstances which might possibly excite the suspicion of wary vigilance; he does not owe to the party who puts the paper afloat the duty of active inquiry in order to avert the imputation of bad faith. * * * The holder's rights cannot be defeated without proof of actual notice of the defect in title or bad faith on his part evidenced by circumstances. Though he may have been negligent in taking the paper, and omitted precautions which a prudent man would have taken, nevertheless, unless he acted *mala fide*, his title, according to settled doctrine, will prevail.'"

Moreover, it is contrary to the doctrine of notice formulated by this Court.

In *Murray* v. *Lardner*, 2 Wall. 110, 121, this Court held:

"Suspicion of defect of title or knowledge of circumstances which would excite such suspicion in the mind of a prudent man, or gross negligence on the part of the taker, at the time of the transfer, will not defeat his title. That result can be produced only by bad faith on his part. The burden of proof lies on the person who assails the right claimed by the party in possession."

This doctrine was reaffirmed in *Hotchkiss* v. *National Banks*, 21 Wall. 354, 359, where Mr. Justice Field said:

"A suspicion that there is a defect of title in the holder, or a knowledge of circumstances that might excite such suspicion in the mind of a cautious person, or even gross negligence at the time, will not defeat the title of the purchaser. That result can be produced only by bad faith, which implies guilty knowledge or wilful ignorance, and the burden of proof lies on the assailant of the title."

III. The judgment herein should be reversed.

Respectfully submitted,

VANVECHTEN VEEDER,
WILLIAM LEE WOODWARD,
WILLIAM J. DEAN,
Counsel for Petitioner.

April, 1927.

Appendix

Privy Council Appeal No. 9 of 1926.

THE CORPORATION AGENCIES, LIMITED.....*Appellants*

v.

THE HOME BANK OF CANADA.....*Respondents*

FROM

THE SUPREME COURT OF CANADA.

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, delivered the 18th JANUARY, 1927.

Present at the Hearing:

VISCOUNT HALDANE.
VISCOUNT FINLAY.
LORD WRENBURY.
LORD DARLING.
LORD WARRINGTON OF CLYFFE.

[*Delivered by* LORD WRENBURY.]

The appellants, Corporation Agencies, Limited (hereinafter called the Company) are a limited company incorporated under the statutes of Canada. They carried on business in the city of Montreal as registrar and transfer agents for registering and transferring shares of the capital stock of certain commercial companies and agents and trustee and financial agents in reconstruction of certain companies. The Merchants' Bank of Canada were their bankers. The Presi-

* Now reported [1927] A.C. 318

dent of the Company was one C. H. Cahan, Senior, one of His Majesty's Counsel, a lawyer of wealth and position in Montreal. His son, C. H. Cahan, Junior, who was also one of His Majesty's Counsel, was a director of the Company. One B. F. Bowler was Secretary-Treasurer. The respondents, the Home Bank of Canada, were the bankers of Cahan, Junior. Between the plaintiff Company and the defendant bank no relation, contractual, fiduciary or other, existed, save such as arose from the transactions presently mentioned.

This action was brought by the Company against the defendant bank, claiming payment of a sum of $209,028.12 (afterwards corrected to $205,960.37), being the amount of 94 cheques amounting to the sum last above-mentioned drawn upon the Company's account with the Merchants' Bank of Canada, collected by the defendant bank through the Montreal Clearing House, and debited to the Company's account with the Merchants' Bank. These 94 cheques were drawn at various dates between the 29th March, 1919, and the 20th December, 1919, and were as follows:

Number of cheques.	Amounts.
	$
In March, 1919—One cheque	500.00
" April, 1919—Three cheques	1,096.89
" May, 1919—Nine cheques	4,728.75
" June, 1919—Seven cheques	9,680.00
" July, 1919—One cheque	3,500.00
" Aug., 1919—Two cheques	1,850.00
" Sept., 1919—Ten cheques	14,668.96
" Oct., 1919—Twenty-one cheques	46,445.00
" Nov., 1919—Twenty-six cheques	79,220.27
To 20th Dec., 1919—Fourteen cheques .	44,270.50
Total—Ninety-four cheques ...	$205,960.37

Cahan, Junior, who, as already stated, was a director of the Company, was during 1919 engaged in very extensive speculative dealings in stocks and shares on his own private account, and he in fraud of the Company made use of the Company's account with the Merchants' Bank of Canada to assist his operations.

There is a device known in Canada as "kiting," which is described as follows:

"Kiting is a term used with regard to obtaining money by cheques passed through banks without value being deposited against the cheque—that is, kiting is an effort to obtain the use of money during the process of a cheque passing through one bank or through a clearing house to another, and perhaps through many more."

To this Bowler, who was examined as a witness for the defendant bank, adds that kiting is a means of getting credit for the time it takes to clear a cheque from one bank to another bank. Cheques are passed from one bank account to another, and credit is obtained at the bank into which they are paid, for which they are debited at the bank on which they are drawn.

During 1919 Cahan, Senior, was much engaged in business which took all his attention off the proceedings of the Company. Cahan, Junior, and Bowler were substantially in complete control of the Company's affairs, and it was in that state of things that the frauds of Cahan, Junior, which it is necessary to describe, were perpetrated.

The Company's bye-laws contained a bye-law as follows:

"54. Contracts and engagements on behalf of the Company may be made, and cheques, bills of exchange, promissory notes, drafts and other negotiable paper may be made, drawn, accepted or endorsed by the Secretary-Treasurer acting jointly with the Manager or with any Director of the Company, or by the Manager acting jointly with any Director of the Company; or by any two Directors acting together;

provided, however, that cheques, drafts, bills of exchange, promissory notes or other negotiable paper may be endorsed for deposit only in the Company's bank account by either the Manager or the Secretary-Treasurer acting alone."

The following is a copy of the first of the cheques in question, that of the 29th March, 1919:

No. 6080. Montreal, Mar. 29, 1919.

Corporation Agencies, Limited.

Pay to the order of C. H. Cahan, Junior, $500.00 Five Hundred Dollars.

Corporation Agencies, Limited.
C. H. Cahan, Junior, Director.
B. F. Bowler, Secretary-Treasurer.

To the Merchants' Bank of Canada,
Montreal.

Of the 94 cheques, 67, amounting to $146,429.87, were drawn as above; six, amounting to $16,530.50, were similar, except that they were drawn payable to the order of the defendant bank. The rest, 21 in number, amounting to $43,000, were drawn in the same way and were made payable to Cahan, Junior, or to agents of his, or to bearer. A few of the cheques, some 18 in number, were cashed over the counter. In all other cases the cheques were duly endorsed and were paid into Cahan Junior's account with the defendant bank, and were collected in ordinary course by the defendant bank through the Montreal Clearing House from the Merchants' Bank of Canada. In the case of six cheques, "E. Wright, Director," instead of B. F. Bowler, was the second signature in addition to that of Cahan, Junior. No importance is attributed to this fact.

On the night of the 26th-27th December, 1919, Cahan, Junior, absconded, and his whereabouts were subsequently unknown. The facts of the frauds he had committed then came to light.

Cahan, Junior, held a power of attorney from his father to draw upon three banking accounts which his father had, in each of which there was a substantial credit balance. He had also power to draw on the banking accounts of several companies. He was thus in a position to draw on some twelve banking accounts or more and to carry on "kiting" operations, and did so to a very large extent. The general effect of his operations may be described as follows: He and Bowler (who was throughout a party to his proceedings) drew a cheque on the Merchants' Bank of Canada. Cahan, Junior, paid it into his own private account at the defendant bank. At the moment when they drew that cheque there was in most cases no sufficient balance at the Merchants' Bank to meet it. But on the same day Cahan, Junior, paid into that account a cheque drawn by him on some of the other accounts on which he had power to draw, with the result that the plaintiffs' account with the Merchants' Bank was or at any rate became by the end of the day in credit to an amount sufficient to meet the cheque in his favour. An illustration may be given by taking the case of the first cheque, that of the 29th March, 1919, for $500. On the 29th March the credit balance at the Merchants' Bank was only $61.74. The cheque of the 29th March was cleared on the 31st March. On the 29th March $270 and on the 31st March $250 were paid by Cahan, Junior, into the credit of the account, with the result that on the 31st March there was enough to meet the cheque for $500 and to leave a credit balance of $81.74. This is a fair sample of what was done throughout. The 94 cheques were never met by moneys of the plaintiffs. Cahan, Junior, simply paid in and drew out money which he was obtaining by fraud from his father's accounts or the other accounts which have been already mentioned. The plaintiffs' account with the Merchants' Bank was never overdrawn

except on one or two occasions to very small amounts. The cheques that came in and went out always offset each other. From March to December, 1919, no more than $5,890.34 was paid into the Merchants' Bank and $8,402.35 drawn out in respect of the regular business of the Company. The difference between these two sums came out of the funds irregularly deposited by Cahan, Junior.

During the whole of that time the Company was practically dormant. All the rest of the payments into the account and the whole of the amount which was by the 94 cheques drawn out of the account had nothing to do with the Company's business or the Company's moneys. The trial Judge found as a fact that none of the 94 cheques were paid out of the Company's funds.

Having thus sketched the facts upon which the question arises, their Lordships go on to consider what is the law applicable to the case. The question here is whether the defendants had notice or knowledge. This is question of fact. In *John* v. *Dodwell*, 1918, A. C. 563, 569, Lord Haldane, in delivering the judgment of this Board, said, "When an agent is entrusted by his principal with property to be applied for the purposes of the latter and to be accounted for on that footing, he is . . . in a fiduciary position, and any third person taking from the agent a transfer of the property with knowledge of a breach of duty committed by him in making the transfer holds what has been transferred to him under a transmitted fiduciary obligation to account for it to the principal." And again at p. 570, "If the appellants received such money with notice of the trust affecting it, they would be bound to account for it to the respondents." In *John* v. *Dodwell*, Williams, the manager for Dodwell and Co., who was authorized by Dodwell and Co., the plaintiffs (respondents) to draw, and who drew the cheques on the plaintiffs'

account, employed the defendants (appellants) as his brokers and gave them cheques on the plaintiffs' account in payment for shares, and they received them with knowledge that Williams, without apparent authority, was drawing for his own purposes on the plaintiffs' funds. The case turned, as does the present case, on knowledge. If there was no knowledge, it has no application.

By virtue of article 54 of the Company's bye-laws Cahan, Junior, as a director, and Bowler as secretary-treasurer, were authorized to draw on the Company's account at the Merchants' Bank of Canada, and they did so. Mr. Justice Maclennan, the Judge before whom the action was first tried, considered that the form of the cheques on their face was notice of the fact that Cahan, Junior, was appropriating to his own use the Company's moneys. Mr. Justice Duff and Mr. Justice Newcombe (the minority Judges on the appeal) were of the same opinion. Their words are "having notice, of which the cheques themselves were *prima facie* evidence, that Cahan, Junior, the defendants' endorser, was not entitled to the cheques." And again, "The cheque on its face is evidence of the absence of authority for the exercise of his powers for a purpose which is incompetent to him." Their Lordships do not agree. In their opinion, the majority in the Supreme Court were right in holding that the form of the cheques did not give notice and that the defendants had not notice.

For by way of illustration, take again the first cheque, that for $500, of the 29th March, 1919. When Cahan, Junior, paid that cheque into his account at the defendants' bank, suppose the bank had asked, "For what is this cheque given?" would he have been bound to answer? The cheque might have been for salary or for a sum due to Cahan, Junior,

on any other account. The defendant bank had no duty to enquire as to the obligation in respect of which it was given. They would in ordinary course of business take the cheque and if on presentation to the Merchants' Bank payment were refused, they would debit their customer with the amount.

During April three like cheques for $300, $498.74, and $298.15, were endorsed and handed to the defendant bank by Cahan, Junior. The practice of the Merchants' Bank was not to issue a pass-book, but to render monthly accounts. Such monthly accounts were duly rendered for March and April, 1919, to the Company. These contained the cheques above referred to. Thus the plaintiffs knew (so far as the defendant bank had knowledge or reason to believe) that the March and April cheques, drawn as they were in favour of Cahan, Junior, were being accepted by the Company as being on their face in order. And so matters went on during the subsequent months, and *a fortiori* the defendant bank had every reason to believe, as successive monthly accounts were sent and no objection raised, that the cheques were legitimate and not in fraud of the Company. The Company were, unfortunately for them, in the hands of fraudulent agents, but the defendant bank had neither knowledge nor notice that that was so, and, in fact, from the unquestioned acceptance of the monthly accounts, were entitled to believe the contrary.

Moreover, the fact was that the plaintiffs' moneys were not being appropriated and applied by Cahan, Junior, at all. His father's moneys and the moneys of the various companies on whose accounts he was entitled to draw and did draw were no doubt being misappropriated, but so far as the plaintiffs were concerned Cahan, Junior, was doing no more than paying into their account moneys which did not belong to them and drawing out to the like amount moneys with which the

Company, in fact, had no concern. Neither the payments into nor the drawings out of the Company's account were authorized acts. The Company cannot repudiate the one and take the benefit of the other. They are, in fact, not concerned with either. The plaintiffs lost nothing by the kiting transactions. If they now recovered the $205,960.37 from the defendant bank they would be making that sum as a profit if they kept it, and if they did not keep it, but were compelled by action brought by those whom Cahan, Junior, defrauded to pay it over to Cahan, Senior, or others whom Cahan, Junior, defrauded, they would be giving effect to rights whose existence the Board cannot in this proceeding investigate or determine, and with which in this proceeding they have nothing to do, for Cahan, Senior, and the companies concerned are not parties to this litigation.

Upon both grounds, viz., that the defendant bank had not notice or knowledge and that, in fact, the Company have sustained no loss, their Lordships are of opinion that the majority in the Supreme Court are right, and that this appeal must be dismissed with costs.

They will humbly advise His Majesty accordingly.

FIL
APR 1
WM. R. STA

Supreme Court of the United States

OCTOBER TERM, 1925.

No. [redacted] 318

EMPIRE TRUST COMPANY,
Petitioner-Defendant,

against

CHARLES HAZLITT CAHAN,
Respondent-Plaintiff.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Supreme Court of the United States

EMPIRE TRUST COMPANY, Petitioner-Defendant, *against* CHARLES HAZLITT CAHAN, Respondent-Plaintiff.	October Term, 1925. No. 1055.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

The decision of which petitioner seeks review by writ of *certiorari* was rendered by the Circuit Court of Appeals for the Second Circuit (Judges Hough, Learned Hand and Mack sitting) on January 4, 1926. It is reported in 9 F. (2nd) 713, and is printed at pages 266-285 of the Record. It affirmed, except as it directed a modification so as to add interest to the amount of the recovery, a judgment of the District Court for the Southern District of New York in favor of the plaintiff below entered on a verdict directed by the Trial Judge (Judge Winslow) on cross motions for directed verdicts made by both parties at the conclusion of all the evidence, pursuant to stipulation entered into at the opening of the trial providing therefor and that the case should be tried before a jury of one (Record, pp. 29, 153). Judge Winslow's opinion is not reported but appears at pages 241-244 of the record.

For convenience, we shall adopt the terminology of the petition and refer to the petitioner as "defendant" and respondent as "plaintiff."

Statement.

The statement of facts in the Petition, while summary, is on the whole fair and accurate. Reference must be made, however, to certain features of the case which defendant's statement does not develop, but which in our view have an important bearing on the extent of the notice to be imputed to defendant that Cahan, Jr., was using his principal's funds for his own purposes.

When the second check in this series, that of August 2, 1916 (Pl.'s Exh. 5-A, Record, p. 164) was presented to defendant by Cahan, Jr., for deposit in his personal account, it was pointedly brought by the teller to the attention of a responsible officer of the defendant, Mr. Lyon. He testified (Record, pp. 141-143) that a rule of the bank prevented the depositor from drawing against a check, even if certified, the same day on which it was deposited, unless it was approved "for immediate credit" by an officer. Cahan, Jr., on August 2, 1916, asked that the $5000 check deposited on that day be taken as a "cash item" for immediate withdrawal and the receiving teller in accordance with the rule brought it for approval to Mr. Lyon, who, after seeing the whole check, approved it without inquiry.

When the next check of the series in question, that of $2,000, on September 1, 1916 (Pl.'s Exh. 5-B, Record, p. 165), was presented by Cahan, Jr., for deposit, he apparently did not secure its approval "for immediate credit." Nevertheless, the transcript of Cahan, Jr.'s account with

defendant (Pl.'s Exh. 11, Record, pp. 197-214) shows (last item on p. 204) that he made a withdrawal on that same day of such an amount that his account would have been overdrawn but for this deposit. Whether the account was technically overdrawn,—*i. e.*, whether the withdrawal preceded the deposit,—cannot be determined from the transcript of the account, and Mr. Banks, defendant's auditor, testified that he could not tell (Record, pp. 115-116). The same situation appeared on April 12, 1917, and May 26, 1917 (transcript of account, Record, pp. 209, 210) when there were withdrawals which would have overdrawn Cahan, Jr.'s account but for deposits on the same day of his principal's funds. The only difference between these and the September 1, 1916, transaction is that in the account these deposits appear on a line above the withdrawals, which Mr. Banks testified was some indication that the deposit preceded the withdrawal (Record, pp. 104-105, 111-113). But in view of his other testimony as to the manner in which deposits and withdrawals were entered on defendant's books (Record, pp. 117-120) this was of slight probative value as to the actual chronology.

As to these three occasions the Trial Judge found in his opinion (Record, p. 243):

> "Whether the checks were drawn to pay the agent's indebtedness to the defendant (which would seem to be the case in three instances referred to) • • • •."

It must be taken as established that all of the checks sued on were frauds by Cahan, Jr., against the plaintiff, his father. Plaintiff's undisputed testimony to this effect (Record, pp. 44, 46, 48-49, 76-77) was corroborated by the

fact that Cahan, Jr., covered up these checks by false entries on the stubs of the plaintiff's check books or by omitting such entries entirely (Record, pp. 49-60, 63-75; Pl.'s Exhs. 6 to 6-J, pp. 183-185). While plaintiff testified as defendant says (Petition, p. 5) that he had no knowledge of exactly what Cahan, Jr., did with these funds, he did know and testified explicitly that the proceeds of these checks were not withdrawn or used for any purpose of the plaintiff (Record, pp. 88, 91-92) and the inference is clear that Cahan, Jr., misappropriated them to his own use.

There is no evidence that the defendant ever inquired of the plaintiff, or of anyone else, as to Cahan, Jr.'s authority to draw these checks or to dispose of them for his own benefit.

It must be remembered that both parties made cross motions for directed verdicts at the conclusion of the trial. This procedure had the effect of submitting all disputed questions of fact to the Trial Judge. His direction of a verdict therefore settled all material facts, and all justifiable inferences therefrom, in the plaintiff's favor. *Beuttell* v. *Magone*, 157 U. S. 154, 157-158; *Empire State Cattle Co.* v. *Atchison Railway Co.*, 210 U. S. 1, 8-9; *Sena* v. *American Turquoise Co.*, 220 U. S. 497.

We may therefore conclude this discussion of the facts with a quotation of three other passages from the opinion of the Trial Judge, which amount to findings of fact on his part, binding upon the appellate courts unless they were not supported by any evidence, which of course was far from the case.

> "The proceeds of the checks thus deposited with the defendant were used by Cahan, Jr., for his per-

sonal use and benefit, and not for the benefit or account of the plaintiff" (Record, p. 242).

* * * * * *

"The agent did not in fact have actual authority either to draw these particular checks or to deposit them to his personal credit with defendant" (p. 242).

* * * * * *

"Even if the actual good faith of the defendant be not questioned, the form of the checks should have led the defendant to inquire, in which event the real facts would have come to light. Failure to make this inquiry amounts to 'bad faith', in a commercial sense" (p. 243).

POINT I.

The decision of the Circuit Court of Appeals herein does not require review by this Court.

That the question decided is important we do not deny. But we take direct issue with the statement in the petition (p. 6) of the alleged reasons for review.

No question of local law is involved and therefore the alleged conflict between the decision and the law as laid down by the New York State courts presents no special ground for review. The New York decisions are of course entitled to consideration, with those of other states, in determining whether the decision is in conflict with the weight of authority.

It is to this question, and to the question whether there is any substantial conflict between the circuit courts of appeals of different circuits, that our argument will be specifically addressed.

1. *There is no substantial conflict between the decisions of the various circuit courts of appeals "on the same matter."*

Briefly our position is that the statement in the petition that this decision is in conflict with the law as declared by the Circuit Courts of Appeals for the Third, Sixth and Ninth Circuits is demonstrably erroneous; that the only decision of a federal appellate court which is even apparently inconsistent with the principles laid down by the Court herein is *Santa Marina Co.* v. *Canadian Bank of Commerce*, 254 Fed. 391 in the Ninth Circuit; and that there were features in this case which distinguish it from that one.

The decision below laid down no new principle of law. It is simply an interesting application of the ancient rule that a third person who receives funds from an agent, with knowledge or notice of the fiduciary relationship with respect to those funds and of such facts as should lead him to suspect that the principal probably did not intend that he should receive them, takes the funds at his peril.

What is sufficient notice to put the third person upon inquiry is always a question of degree. The authorities are unanimous in holding a bank or other person conclusively liable if it takes a check, drawn by an agent in the name of his principal, in payment of the agents' individual indebtedness to it. *National Bank* v. *Insurance Co.*, 104 U. S. 54, *Ward* v. *City Trust Co.*, 192 N. Y. 61, *Rochester & C. T. R. Co.* v. *Paviour*, 164 N. Y. 281, and *Gerard* v. *McCormick*, 130 N. Y. 261, are illustrative cases of this universal rule, which is not denied by defendant (Brief, p. 9). But the reason for this result is not that the debt is paid, but that this circumstance is a strong indication that the agent is using his principal's funds for his own purposes with-

out authority. Even in this situation there is no certainty of wrongdoing. It is entirely possible that, by reason of a collateral transaction between the agent and the principal, the agent is entitled to use the principal's funds for his own purposes. But this possibility is remote and, on a balance of probabilities, the courts all hold that such a transaction is so suspicious that the taker of the funds is put upon inquiry.

It is only another application of the fundamental rule above stated to hold, as in the instant case, that a bank is put on notice where an agent deposits checks showing on their face that they represent funds belonging to his principal to the credit of the agents' individual account. The natural and probable consequence of the transaction is that the agent will use the funds to satisfy his private obligations, or otherwise for his individual purposes. Again there is a possibility that the transfer of the funds from the principal's account to the personal account of the agent may be with the former's authority. But again the possibility is remote. It is difficult to assign a rational explanation of what purpose of the principal's such a transfer would subserve. Defendant says (Brief, p. 11) that "the deposit with the defendant bank did not operate to take the funds out of his son's control." But it did operate to take the principal's funds out of the principal's control. While the funds were on deposit with the Guaranty Trust Company and the Agents of the Bank of Montreal, the plaintiff could draw checks upon them himself. He could also, by mere revocation of the powers of attorney, deprive Cahan, Jr., of all power over them. But once they were transferred to Cahan, Jr.'s individual account with the defendant, the plaintiff's control over them ceased. The

defendant bound itself by its contract of deposit to honor any check that Cahan, Jr., might draw and none which anyone else, including his principal, the plaintiff, might draw.

The decision in the instant case did not even present any novel application of established principles. Its result was clearly foreshadowed by the opinion of the same court as early as 1913 in *Havana Central Railroad Co.* v. *Central Trust Co.*, 204 Fed. 546, which this Court declined to review by certiorari (234 U. S. 755). That decision is a striking illustration of the fact that the question of the liability of a bank in dealing with commercial paper drawn by a known agent is always a question of degree,—of the extent of notice. That was an action against the bank in which the principal carried its account and on which the agent, a corporate officer, drew checks in the name of his principal, by himself as agent, to his own order. (We shall for brevity refer to a bank in such position as the "drawee bank" and the bank in which the agent deposits the check to his individual credit as the "agent's bank".) The Circuit Court of Appeals held that the defendant (the drawee bank) was not liable for paying such checks in the circumstances disclosed in that case, among them the fact that checks similarly drawn had gone through without question, that the form of the checks was consistent with an innocent purpose, and that the *drawee bank* was not in a position to know what the agent's purpose was. But the court said (p. 551) that it was "far from holding that a bank is free under all circumstances to pay without question checks drawn by corporate officers to their own order", and that "a check misused by a corporate officer cannot be regarded by a bank having notice of its

misuse as an authorized order." However, said the Court (p. 550):

> "*The defendant* (the drawee bank) did not know the history of the checks. It did not have *the knowledge of the Knickerbocker Company* (the agent's bank) that the Treasurer was using the checks for his personal benefit."

and at page 551:

> "But if the bank have knowledge that the officer *is using the check for his personal benefit*, e. g., to pay his debt to the bank *or to deposit it to his personal credit*, then the bank is put upon inquiry and if it fail to make it, pays at its peril." (Italics ours).

It is not necessary to repeat here the explanation by the Court below in its opinion (Record, pp. 272-276) of the extent of its ruling in the earlier case and the relation thereto of the *Havana Central* litigation in the State courts of New York.

Defendant's basic position (Brief, p. 10) that "the form of the checks drawn to the agent's order imported ownership of the proceeds in Cahan, Jr.", had been repudiated as early as 1888 by Judge Wallace in *Anderson* v. *Kissam*, 35 Fed. 699, 703, where, distinguishing the case in which an agent comes with money in hand, he said:

> "When he comes with money obligation of a corporation, which is the contract of a corporation only because he has made it, and which is not its contract if he has made it without authority, the transaction is a very different one. * * * No principle

> of the law of agency is better settled than that no person can act as the agent for another in making a contract for himself."

This is an application of the well-established rule that into every power of attorney to an agent to act "for", "on behalf of" or in the "name, place and stead of" a principal, the law reads the limitation that such power of attorney is not to be construed as including authority to use it for the agent's own benefit unless there be express language to that specific effect. *Stainer* v. *Tysen*, 3 Hill (N. Y.) 279; *Bank of New York* v. *American Dock & Trust Co.*, 143 N. Y. 559, 564; *Porges* v. *United States Mortgage & Trust Co.*, 203 N. Y. 181; *Park Hotel Co.* v. *Fourth National Bank*, 86 Fed. 742 (C. C. A., 8th Circ., per Sanborn, C. J.); 2 *Corpus Juris* 642, 643; 1 *Daniel on Negotiable Instruments*, Sec. 282.

We may now consider defendant's assertion that the decision of the Court below is contrary to the law as declared by the Circuit Courts of Appeals for the Third, Sixth and Ninth Circuits.

The only case cited from the Third Circuit is *Postal Telegraph-Cable Co.* v. *Citizens National Bank*, 228 Fed. 601, the facts in which bear no resemblance whatever to those of the instant case. It had to do with the drawee's liability on forged drafts. No question of agency or notice of an agent's use of fiduciary funds for his own benefit was presented. Indeed defendant makes no serious contention that the instant case conflicts with it, except with respect to the rule as to notice which we discuss hereafter.

Two cases are cited from the Sixth Circuit, neither of which conflicts with the instant case.

The first, *Warren-Scharf Asphalt Paving Co.* v. *Commercial National Bank*, 97 Fed. 181, protected the payment by the *drawee bank* to the "attorney and cashier" of a corporation of a check drawn by him upon its bank account to the order of "cash," a form of draft which he had customarily used for the purpose of meeting the company's pay-roll. The case was therefore of the same general nature as the *Havana Central* case in the Second Circuit, and is entirely consistent with it. Indeed there was even less basis for a criticism of the drawee bank's conduct than in the *Havana Central* case because the check was drawn not to the agent's own order but to the order of "cash."

In the other Sixth Circuit case, *Commercial Savings Bank & Trust Co.* v. *National Surety Co.*, 294 Fed. 261, one F. received a check to the order of "F., Trustee." He deposited it in his personal account with the defendant, but a few days later withdrew from that account a larger sum by a check to the order of "F., Trustee." The bank was held not liable for his misappropriation of these funds to which he at all times had legal title and over which he had exclusive power of disposition. The inapplicability of that case to the present is shown by the following reasoning of the Court (p. 264):

> " * * * even if the bank were to be charged with knowledge that it received this money from a trustee, it later returned the money to the same trustee, and certainly cannot now be held for the subsequent embezzlement of the funds, to the possession of which, in so far as this bank was concerned, the trustee was clearly entitled."

In the Ninth Circuit the law was early laid down in harmony with the result of the instant case in *Farmers' Loan*

& Trust Co. v. *Fidelity Trust Co.*, 86 Fed. 541. In that case the general agent of a corporation drew a draft upon its treasurer, and sold it to his bank for a certificate of deposit in his name as an individual. The Court, in holding that the bank was liable for the resulting misappropriation, said that if the agent had taken cash the presumption would have been that he was taking it for his principal's purposes, and continued (pp. 544-545):

> "But when the agent, for such a draft, asks for and receives from the bank a certificate of deposit in his individual name, not only is such bank thereby put upon inquiry as to why, for money of the principal, the agent wants such certificate in his individual name, but such conduct—nothing to the contrary appearing—is equivalent to a declaration by the agent that the money is received by him in his individual capacity, and for his individual use; for certainly the legal presumption that follows the deposit of money in the individual name of a man is that the money so deposited is the property of the depositor."

Defendant's attempt to distinguish this case (Brief, p. 17) is most ineffective. Why the giving of a certificate of deposit should be regarded as differing in effect from the entering of a deposit in an individual bank account is not obvious.

This brings us to the later decision of the Ninth Circuit in *Santa Marina Co.* v. *Canadian Bank of Commerce*, 254 Fed. 391, which this Court also ...d to review on certiorari, 250 U. S. 643. In that case one Hooper, an officer of a corporation, having authority to endorse and deposit checks payable to its order, endorsed in blank several such checks and deposited them in his individual bank

account with the defendant. The District Court (242 Fed. 142) held the defendant liable to the amount of those checks which were "deposited at a time when Hooper was indebted to the defendant bank in certain overdrafts" (254 Fed. p. 397), but not on the other checks. The plaintiff alone appealed and the Circuit Court of Appeals affirmed the judgment.

We regard that decision as incorrect and certainly it cannot be denied that it proceeds from a point of view at variance with that of the court in the present case. That case, however, was not, like this one, an action at law for conversion, but a suit in equity to charge defendant as a trustee, and the opinions both of the lower court (242 Fed. p. 145) and of the Circuit Court of Appeals (254 Fed. p. 396) indicate that considerable weight was attached to the form of the action. Moreover, there are circumstances in the instant case which in our view distinguish it.

We refer to the occasions above described on August 2, 1916, when one of this series of checks was presented by Cahan, Jr., "for immediate credit" and so brought for approval to one of defendant's officers, and on September 1, 1916, April 12, 1917, and May 26, 1917, when Cahan, Jr.'s, withdrawals were of such size that his account would have been overdrawn but for the deposit therein of his principal's funds. As to the August 2, 1916, transaction, which was presented as a whole to a responsible officer, it is difficult to imagine what necessity, consistent with faithfulness on the part of Cahan, Jr., that officer could have seen for having these funds marked specially for immediate withdrawal. Certainly it could not be the necessity of paying his principal's obligations. That could be done as well by checks on the principal's bank accounts. The necessity for

"immediate credit" must have been Cahan, Jr.'s, individually.

Again in the *Santa Marina Case* the plaintiff recovered to the extent of the deposits of the principal's funds made at a time when the agent's account with the defendant was overdrawn. We submit that no rational distinction may be drawn between that case and the situation with respect to Cahan, Jr.'s account with defendant herein on September 1, 1916, April 12, 1917, and May 26, 1917, when defendant honored Cahan, Jr.'s drafts on his personal account only because it received on the same day,—and probably at the same moment,—checks on his principal's funds drawn by the agent to his own order. The principle laid down in *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106, that a bank which takes fiduciary funds in payment of the fiduciary's indebtedness to it, is so clearly put on notice that it is liable not only for that item but for all his subsequent defalcations, would be a sufficient ground for plaintiff's recovery herein of all except the amount of the first check of the series.

It is true that the features which we have above emphasized were not referred to by the Court below, which preferred to rest its decision on a broader ground. But they are in the case, and it is proper for this Court to consider them in determining whether the decision is in conflict with the decision of another circuit court of appeals "on the same matter". We submit that it is not.

Another important expression of opinion by a circuit court of appeals is quite in accord with the decision of the Court below. In *Oklahoma State Bank* v. *Galion Iron Works*, 4 F. (2nd) 337, the Circuit Court of Appeals for the Eighth Circuit said (pp. 338-339):

> "That an agent may not deposit funds collected by him for his principal with a bank to his own individual credit, and draw them for his own personal and private use, in the absence of authority from his principal is well settled, and when a bank with knowledge that its funds belong to the principal and not the agent, which was apparent from the face of the warrants, permits him to do so, it is liable to the principal for the moneys, thus deposited and withdrawn by the agent on his individual check and by him converted to his own use, and embezzled, unless the agent acted within the apparent scope of his authority, which is not claimed, or the principal, with knowledge of the acts of the agent permits him to do so, or ratifies his acts."

2. The decision is not untenable or in conflict with the weight of authority.

There is unquestionably a conflict of authority in the various state courts on the questions involved in this case. In some instances the decisions in a single state, notably New York, are not in harmony. But review of the decision in question by this Court would have slight effect upon such a wide divergence of views as are entertained by the state courts.

Coming directly to defendant's assertion that the decision is contrary to the law as laid down by the courts of last resort of New York, Massachusetts, Connecticut, Pennsylvania, Maryland, West Virginia, Missouri, California, Washington and England, we submit that the statement is exaggerated.

The decisions in Massachusetts (especially *Kendall* v. *Fidelity Trust Co.*, 230 Mass. 238) and Washingson (*Mott Iron Works* v. *Metropolitan Bank*, 78 Wash. 294) are in-

deed contrary to the principles upon which this case was decided, disregarding the particular circumstances above described.

However, the cases cited from Connecticut (*Goodwin v. American National Bank*, 48 Conn. 550), Pennsylvania (*Hood v. Kensington National Bank*, 230 Pa. St. 508, and *Safe Deposit & Trust Co. v. Bank*, 194 Pa. St. 334), West Virginia (*United States Fidelity & Guaranty Co. v. Home Bank*, 77 W. Va. 665), and California (*Southern Trust & Commercial Bank v. San Diego Savings Bank*, 212 Pac. 385, and *United States Fidelity & Guaranty Co. v. First National Bank*, 18 Cal. App. 437, neither of which, by the way, was a decision of the court of last resort) all had to do with the misappropriations of a fiduciary like an executor, administrator, guardian or town treasurer who had the legal title or the exclusive right of control of the fund. There is an important difference between these cases and those involving a mere agent. An estate can act only through its executor or trustee. Therefore in the case of an executor or trustee or other fiduciary who has the legal title or *exclusive* right of control, it may fairly be said that the control of the fund remains the same when it is deposited in the individual name of the executor or trustee. But a principal may act either personally or through other agents and therefore, if one agent deposits the principal's fund to his individual credit, the control is vitally changed. Then only *that* agent can act with respect to it. It is taken out of the control of the principal.

The case cited from Maryland (*Duckett v. Mechanics Bank*, 86 Md. 400) supports our position rather than defendant's. One of the two checks there involved was drawn to the order of a cashier for deposit to the order

of "C Trustee". The defendant bank permitted C to deposit this in his individual account. The court held the bank liable for the amount of this check, using the language which the court in the instant case quotes in its opinion (Record, p. 277). Certainly there is no difference in substance between that case and one in which the bank takes for credit to a fiduciary's individual account a check drawn by him as fiduciary to his own order.

The cases cited from Missouri strikingly illustrate the point that the question of the sufficiency of the notice is all one of degree and each case must rest upon the particular circumstances disclosed. In the first case cited, *McCullam* v. *Third National Bank*, 237 S. W. 1051, the Court holds, in a thoughtful opinion, that while the facts in a given case may frequently be such as to charge a bank with notice that a transfer by an officer of a corporation to his individual account was probably a misappropriation, the circumstances in that case indicated the contrary. There was evidence that a large part of the corporation's business was transacted through the officer's personal account, by reason of the fact that the corporation was failing and heavily indebted to its own banks. It was shown that another officer of the corporation knew and acquiesced in these transfers and indeed there was no proof that the officer in question had in fact misappropriated anything. *Gate City Building & Loan Assn.* v. *National Bank*, 126 Mo. 82, involved a similar state of facts. The "general fiscal agent" of the plaintiff association had a personal account and an association account with the same bank, the defendant. He had for a long time endorsed checks which had been made to the order of the association sometimes into one and sometimes into the other account,

without objection by the other officers, and had customarily adjusted the two accounts by drawing checks on his personal account to the credit of the association account. The other Missouri case cited, *State* v. *Chicago Bonding Co.*, 215 S. W. 20, is not at all in point.

The English cases cited by defendant (*Gray* v. *Johnston*, L. R. 3 Eng. & Ir. App. 1; *Coleman* v. *Bucks & Ozon Union Bank*, [1897] 2 Ch. 243, and *Shields* v. *Bank of Ireland*, [1901] 1 Ir. Rep. 222) all involve deposits by executors or trustees, who had the legal title. Those cases must be regarded as going off on that distinction because there is an important body of English law which supports the present decision. *Ex Parte Darlington District Joint-Stock Banking Co.*, 4 De G., J. & S. *581, *585-6; *John* v. *Dodwell & Co.*, [1918] A. C. 563, 568-9; *Ross* v. *London County Westminster & Parr's Bank, Limited*, [1919] 1 K. B. 678, 686; *A. L. Underwood, Ltd.* v. *Bank of Liverpool*, [1924] 1 K. B. 775. Defendant's attempt to distinguish the last-cited case (Brief, p. 16) cannot succeed. It is quite true that the checks as drawn imported ownership in the company. But the effect of Underwood's endorsing the checks as sole director and depositing them to the credit of his individual account was the same as Cahan, Jr.'s, drawing of the checks in the instant case and depositing them to his personal credit.

The condition of the New York authorities is peculiar. There are ruling decisions of the Court of Appeals which fully support the position of the plaintiff herein (*e.g.*, *Wagner Trading Co.* v. *Battery Park National Bank*, 228 N. Y. 37; *Porges* v. *United States Mortgage & Trust Co.*, 203 N. Y. 181, and *Sims* v. *United States Trust Co.*, 103 N. Y. 472, the last-cited case being particularly apposite to

the three checks which Cahan, Jr. drew, not to his own order, but directly to the defendant). Of the cases cited by defendant, *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106 and *Fidelity & Deposit Co.* v. *Queens County Trust Co.*, 226 N. Y. 225, involved trustees or other officers who had the legal title, and in the former case that fact was emphasized (218 N. Y., p. 110); *Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 198 N. Y. 422, the facts of which were substantially similar to those of the instant case, absolved the agent's bank from liability, not on the ground that the form of the checks did not impose on it a duty of inquiry, but on the ground that the drawee bank was the agent of the depositor to make representations as to the validity of the checks and that the agent's bank satisfied its duty by presenting them for payment; and in *Whiting* v. *Hudson Trust Co.*, 234 N. Y. 394, a repetition of this admittedly erroneous doctrine was avoided only by announcing an equally unique and erroneous view of the effect of certification. We cannot improve upon the discussion of those cases in the opinion of the Circuit Court of Appeals itself (Record, pp. 274-276, 282-283). Certainly the fact that that Court felt constrained to depart from the extraordinary doctrines announced in those two decisions of the New York Court of Appeals furnishes no reason for its review by *certiorari*. It is fair to point out in a national court that the decisions of the New York Appellate Division have been uniformly in harmony with the decision of the Circuit Court of Appeals herein. *Havana Central Railroad Co.* v. *Knickerbocker Trust Co.*, 135 App. Div. 313; *Niagara Woolen Co.* v. *Pacific Bank*, 141 App. Div. 265, 268-9; *Newman* v. *Newman*, 160 App. Div. 331, 335; *Eyre* v. *Coal & Iron National Bank*, 208 App. Div. 686, 693-4, and *Spaulding* v. *Kelly*, 43 Hun, 301 (Gen. Term).

The other cases cited in the brief from jurisdictions which are not named in the petition (p. 6) as opposed to the holding herein are all distinguishable, on various grounds.

Besides the above cited New York cases, the decision of the Circuit Court of Appeals herein is supported by the most recent decisions of the courts of England, above cited, and by decisions of the courts of last resort of Tennessee (*U. S. Fidelity and Guaranty Co.* v. *People's Bank*, 127 Tenn. 720); Mississippi (*Bank of Hickory* v. *McPherson*, 102 Miss. 852), and Maryland (*Duckett* v. *Mechanics Bank*, 86 Md. 400, and see *Duckett* v. *Bank of Baltimore*, 88 Md. 8). See also *United States Fidelity and Guaranty Co.* v. *Adoue*, 104 Tex. 379.

3. *The decision is not contrary to the decisions of this court with respect to notice.*

Defendant's second point involves a misconception of the principles regarding notice which this Court has applied in the cases cited by defendant to purchasers of stolen negotiable paper. The Circuit Court of Appeals for the Second Circuit recognizes the rule laid down in those decisions in proper cases and has recently applied it. *Gerseta Corporation* v. *Wessex-Campbell Silk Co.*, 3 F. (2nd) 236; *Mack* v. *Dailey*, 3 F. (2nd) 534.

But the language of those decisions cannot properly be applied, in the way for which defendant contends, to cases such as the present. A bank is not entitled to close its eyes to notice of an agency relation and a probable misuse by the agent of his principal's funds, appearing *on the face of the instrument itself*. Indeed, failure to inquire into those circumstances involves "wilful ignorance" within the lan-

guage of the cases cited by defendant. As this Court said in *Angle* v. *Northwestern Mutual Life Insurance Co.*, 92 U. S. 330, 342:

> "Actual notice in such a case is not required, even in suits founded upon negotiable securities, where the evidence of its infirmity consists of matters apparent on its face; * * *
>
> "Constructive notice in such cases is held sufficient, upon the ground, that, when a party is about to perform an act which he has reason to believe may affect the rights of third persons, an inquiry as to the facts is a moral duty, and diligence an act of justice."

The section of the New York Negotiable Instruments Law, cited by defendant, is but a codification of the common law, and the courts have always held that "bad faith in a commercial sense" includes a failure to inquire when the facts impose a duty of inquiry. *Rochester & C. T. R. Co.* v. *Paviour*, 164 N. Y. 281, 284; *Ward* v. *City Trust Co.*, 192 N. Y. 61, 70-71; *Fidelity & Deposit Co.* v. *Queens County Trust Co.*, 226 N. Y., 225, 233.

In none of this class of cases, where notice is imputed from the face and form of the check, is there any certainty that the agent's conduct involves misappropriation of funds. The question is always one of degree.

Even in that class of cases where the bank is universally held liable, where the agent uses a check drawn by himself on his principal's funds in payment of a personal indebtedness, there is always a possibility that he is entitled as against his principal so to do. In such cases the bank seldom acts in actual "bad faith" as defendant construes that term.

So when the agent deposits a check representing his principal's funds in his personal account to cover overdrafts therein, this may be with the principal's knowledge and authority. Indeed on defendant's theory (Brief, p. 11), that the agent's transfer of his principal's funds from the principal's account in one bank to the agent's individual account in another is no diversion but a proper deposit for the principal's purposes, this conclusion would be inevitable. The bank would be justified in regarding all withdrawals from the agent's account as *prima facie* for the principal's purposes. Therefore, if such withdrawals produced an overdraft it would be normal and proper to cover it by the deposit of other funds of the principal. But of course such reasoning flies in the face of probabilities and it is unquestioned law that in such cases the bank is liable. *Santa Marina Co.* v. *Canadian Bank of Commerce*, 254 Fed. 391; *Allen* v. *Puritan Trust Co.*, 211 Mass. 409.

In our view it is no less reasonable to hold that the bank is put upon inquiry at the moment the agent tenders his principal's funds, represented by an instrument of the agent's own creation, for deposit to his individual credit. Again there is a possibility that the transaction is innocent,—that the agent is really following his principal's instructions,—but that possibility again is relatively remote. The balance of probabilities is against the propriety of the transaction and it is no undue burden upon the bank to impose upon it the duty of making reasonable inquiry according to all the circumstances.

Such was the view of the Court below in the instant case, and its soundness, as a matter of public policy, is in no way affected by the principles laid down by this Court

as to what notice of circumstances *dehors* the instrument will affect the title of a purchaser of a stolen bill.

CONCLUSION.

The application for a writ of certiorari should be denied.

Respectfully submitted,

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